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State of Montana

Report to the Legislature

December 1990

Performance Audit Report

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Tort Claims Division

Department of Administration

This report contains recommendations for improvement in the operation and management of the Tort Claims Division. The recommendations include:

- ▶ Improving insurance coverage and billing of state agencies.
- ▶ Initiating an active risk management process.
- ▶ Establishing a plan for management of the self-insurance reserve fund.
- ▶ Developing formal policies and procedures for division operations.

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Performance audits conducted by the Office of the Legislative Auditor are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy. In performing the audit work, the audit staff uses audit standards set forth by the United States General Accounting Office.

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Performance Audit

Tort Claims Division

Department of Administration

Members of the audit staff involved in this audit were Jim Nelson, Mike Wingard, Pam Boggs, C. Susan Jensen, and Victoria Murphy.

STATE OF MONTANA

Office of the Legislative Auditor

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December 1990

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The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Tort Claims Division of the Department of Administration.

This report contains recommendations concerning management controls over the division. Recommendations were also made related to the state's insurance programs and self-insurance reserve. Department responses are contained at the end of the report.

We wish to express our appreciation to the department and the staff of the division for their cooperation and assistance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Scott A. Seacat", written over a horizontal line.
Scott A. Seacat
Legislative Auditor

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Administrative Officials

Department of Administration

Dave Ashley, Acting Director

Bob Marks, Deputy Director

Tort Claims Division

Brett Dahl, Administrator (Effective November 1990)

John H. Maynard, Administrator (January 1986 through
November 1990)

George H. Harris, Assistant Administrator

Report Summary

Introduction

The Legislative Audit Committee requested a performance audit of the Tort Claims Division of the Department of Administration. A majority of the audit work involved a review of the Tort Claims Division insurance administration and claims handling procedures. We also examined division functions to determine the types of management controls in place relative to insurance and legal operations.

The Tort Claims Division defends the state against tort actions and provides insurance protection for state government. The division investigates claims, defends lawsuits, and pays property damage and bodily injury claims made against the state.

Insurance Coverage

We determined there was a lack of complete and accurate source data upon which to determine property and auto insurance premiums. As a result, there was no assurance all state assets had insurance coverage and neither the division nor individual state agencies could confirm the accuracy of insurance premiums assessed by the division. We believe the Tort Claims Division should establish specific criteria for the type of source data to be submitted by state agencies and also establish procedures to review the reasonableness of the submitted data.

Incorrect Billing for Commercial Insurance

We reviewed the division's billing of state agencies for commercial insurance premiums. Our review of insurance policies and the subsequent billing of agencies for the premiums for those policies revealed agencies are not always correctly charged. We recommend the division develop and implement procedures to assure all agencies are billed for their portion of commercial insurance premiums.

Inadequate Documentation of Self-Insurance Premium Development

The state's self-insurance program was initially created in 1977 because liability insurance became unavailable or unaffordable from the commercial market. Currently, the division's two primary self-insurance policies are general liability and auto-

Report Summary

mobile insurance. The self-insurance premiums in fiscal year 1989-90 totaled approximately \$2,930,000. The general liability insurance premium is apportioned to the agencies based on a formula which is intended to represent the agencies' liability risk.

Overall, there is limited support for self-insurance premiums set by the division and no assurance the premiums established appropriately consider the risk associated with the coverage provided. We believe the division should evaluate and formally support the self-insurance premium development factors as a division priority in order to help preserve the self-insurance reserve and accurately reflect the costs of self-insurance.

Risk Management

Currently, the division has less than half an FTE organizationally assigned to risk management. Because of this, the division has not had the time or resources to develop or establish a comprehensive risk management strategy. Currently, the division does not have a formalized risk management plan nor has the risk manager been able to do any statewide evaluation of the state's potential risk areas in relation to existing insurance coverage. This is partially evidenced by our audit findings regarding lack of support and documentation for the current insurance premiums, insufficient data on buildings and vehicles, and inadequate loss statistics. Additionally, we found the division does not adequately review insurance policies and deductibles.

We believe the Tort Claims Division should place additional emphasis on risk management by establishing and implementing a formal risk management process. As part of its risk management activities, the Tort Claims Division should develop a formal review procedure for all insurance policies which includes analysis of current costs, claim histories, and evaluation of deductibles.

Agency Acquisition of Commercial Insurance

Section 2-9-201, MCA, states the Department of Administration is responsible for the acquisition and administration of all insurance purchased for the state. We found 7 of 17 state agencies visited had purchased one or more insurance policies in fiscal year 1989-90 which were not obtained or administered by the Tort Claims Division. The total premium cost for these policies was \$88,278. Because the agencies did not consult with the division regarding their perceived needs, there is less assurance the agencies obtained the correct coverage or that they are paying the lowest potential premium.

We recommend the Tort Claims Division develop and communicate policy on the subject of insurance administration which emphasizes the statutory responsibility of the agencies regarding acquisition and administration of insurance. The division should also develop and distribute to all agencies some type of insurance portfolio which generally describes the coverage provided by division-administered policies.

Self-Insurance Reserve Management

According to a 1990 actuary report, the Tort Claims Division's self-insurance reserve fund would need a fund balance of approximately \$19.3 million to cover potential and actual losses. The actual fund balance as of June 1990 was approximately \$6.3 million, leaving a reserve deficiency of approximately \$13 million. The Tort Claims Division does not have a formal plan to either make the self-insurance reserve fund actuarially sound or, as an alternative, a plan to enhance or protect the existing balance.

At present the state's self-insurance reserve may not be adequate to pay significant liability losses based on the actuary's report. Without a plan and/or active management of the self-insurance reserve, we have no assurance the reserve fund will be adequate. We believe the Tort Claims Division should increase its evaluation and management of the self-insurance reserve fund by developing comprehensive loss statistics and establishing a plan for sustaining the fund on an actuarially sound basis.

Report Summary

Claim Documentation

We reviewed 50 percent of the paid and denied claims filed with the Tort Claims Division from July 1, 1986 to March of 1990. Our review of the claim files indicated the division does not adequately document the decision-making process used to either deny or pay a claim. As a result of the division not having sufficient documentation in the claims files, it was difficult to assess whether the division properly handled individual claims. The Tort Claims Division should develop specific policies and procedures regarding claim file documentation to assure consistency and provide support for claim decisions.

Documentation of Settlements

Individual claimants not satisfied with the Tort Claims Division decision regarding a claim can seek legal recourse via the courts. Prior to judicial determination of a claim, the division may reconsider the claim and settle. The Tort Claims Division does not formally document how dollar amounts of settlements are established or what factors are considered when the division decides to settle a case rather than going to trial. We believe the Tort Claims Division should more formally document settlement details to provide both the division and the public with justification for how public funds are expended.

Contract Attorneys

According to a division report on contracted services, over one million dollars was expended on contracted legal services in calendar year 1989. The Tort Claims Division has no formal policies or procedures regarding the selection or monitoring of attorneys who represent the state in tort actions. Additionally, our evaluation of the expense documentation submitted by the contract attorneys revealed the division administrator who selected the attorneys also approved payment of their expenses.

We believe the expenditure of public funds require sufficient documentation to show the decision to select a contract attorney was in the best interest of the state. We also believe the Department of Administration should strengthen internal controls by separating the attorney selection and attorney payment

approval functions and improve contract administration related to contract attorneys.

In-House Attorney Workload

The Tort Claims Division does not currently track the amount of time spent by in-house attorneys on individual cases. As a result, it is difficult to evaluate staff workload and/or accurately establish costs for cases handled by in-house staff. We believe it is important for the Tort Claims Division to document and track the workload of the in-house attorneys in order to develop management information which can be used in making staffing decisions and assessing claim defense costs.

Policies and Procedures

Throughout the audit of the Tort Claims Division we identified routine division activity which was not standardized and/or governed by formal policies and procedures. Potentially, lack of consistency and standardization regarding internal administrative matters makes it more difficult to train new personnel or get consistent work products. Additionally, it makes it difficult to evaluate personnel because there is no formalized criteria or standards to judge against.

We believe the division should develop a comprehensive policy/procedures manual which details internal administrative requirements as well as policies and procedures to guide staff regarding specific job responsibilities.

Conclusion

Overall, our audit findings suggest a need for more active management of the division's operations. We believe if the division establishes a management plan which includes implementation of operational and staffing priorities and increased communication with state agencies, the state will have a more comprehensive insurance program.

Chapter I

Introduction

Audit Objectives

The Legislative Audit Committee requested an audit of the Tort Claims Division of the Department of Administration. The objectives of the audit were:

1. To determine if insurance coverage addresses the needs of state agencies for both commercial and self-insurance programs.
2. To determine if Tort Claims Division operations are managed economically and efficiently.
3. To determine if Tort Claims Division is in compliance with applicable laws and rules.
4. To determine how premiums are established for commercial and self-insurance programs and the reasonableness of how these premiums are apportioned to state agencies.
5. To determine the procedures and costs for handling claims and legal settlements.
6. To determine the reasonableness and consistency of settlements of claims and to identify the factors used in settling or defending lawsuits filed against the state.

Scope of Audit

The audit was conducted in accordance with governmental auditing standards for performance audits. A majority of the audit work involved a review of the Tort Claims Division insurance administration and claims handling procedures. Specifically, the audit focused on the division's commercial insurance and self-insurance programs. We also examined division functions to determine the types of management controls in place relative to insurance and legal operations. We reviewed the insurance policies, employee bonds, and the documentation used to allocate premium costs.

The Tort Claims Division's risk management work was reviewed to determine the extent of risk management and its overall effect on the state's insurance program. We also examined other

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Introduction

state agencies' acquisition of insurance policies. To determine the reasons for agency-obtained insurance, we visited state agencies to identify the type of coverages they possess and to determine their knowledge of, and satisfaction with, operations of the Tort Claims Division. The self-insurance reserve fund used to pay tort claims was examined to evaluate the division's management and utilization of the fund.

During our audit we reviewed a sample of claims submitted to the division to determine the division's policies and procedures for handling claims. We also examined the division's legal operations to assess how claims resulting in lawsuits are procedurally administered. This included determining how it is decided whether in-house or contracted attorneys will represent the state, and identifying what factors are considered when determining whether a lawsuit should be settled or go to trial. We evaluated the division's monitoring of contracted attorneys and examined the outcome of lawsuits over the past four years.

During the audit we examined the division's management controls. We reviewed division policies and procedures and evaluated the division's goals and objectives. We also interviewed division personnel regarding training, staffing needs, and division communication. Our audit primarily focused on division operations for fiscal years 1988-89 and 1989-90; however, we also looked at division procedures for projecting insurance premiums for the 1992-93 biennium.

Data Limitations

Government auditing standards require the disclosure of any constraints imposed on the audit approach because of data limitations. We were hindered in achieving our audit objectives because of limited documentation at the Tort Claims Division. This situation also hindered the division in its management of the tort claims program. Areas where the division had limited data include:

- Documentation to determine if the state's insurance program addresses the needs of state agencies.

- Documentation of claims history needed to determine if self-insurance premiums are allocated correctly and to ascertain the adequacy of the reserve balance relative to actuarial projections.
- Documentation of claims payments/denials and legal settlements to determine if decisions were reasonable and appropriate.
- Documentation of procedures and costs for handling legal cases to determine the efficiency and appropriateness of the use of in-house and contracted attorneys.

These limitations are discussed in detail in Chapters III, IV, V, and VI.

Compliance

As part of the audit we examined compliance with state statutes and administrative rules relating to the Tort Claims Act, the state insurance plan, and bonding of state employees. We generally found the division to be in compliance with applicable laws. However, we did find several instances of noncompliance or partial compliance. These areas are discussed below and in Chapters III, V, and VI.

Management Memorandums

During the audit we asked officials at the Tort Claims Division for written responses to selected audit issues. These areas related to potential report issues and recommendations. In addition, we sent management memorandums to division officials on issues which were less significant. These issues concerned:

- Contrary to state law, the division did not use certified mail to send claim denial response letters to claimants. The division has agreed to comply with the statutory requirement to use certified mail for claim determination responses.
- Several adjusting documents used to enter information on the Statewide Budgeting Accounting System (SBAS) lacked sufficient supporting documentation to adequately explain the reason for the adjustment. Division personnel indicated the adjustments (which were made by a former employee) were most likely made to correct past errors, but they

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agreed the documentation is not sufficient to determine the reason for the adjustments and intend to more fully document future adjustments.

- The division does not have policies and procedures for the use of contracted adjusters who assist division personnel in claims processing. Approximately 12 percent of the claims we reviewed were handled by contracted adjusters; however, the division does not have any formal policies or procedures regarding how claims are assigned to adjusters or what their authority is regarding claim settlements. Department officials indicated guidelines for the use of adjusters will be developed.
- The division does not have a formalized policy/procedures manual for legal operations. As a result, legal personnel do not have a formal specific policy to follow relative to the type and amount of documentation they should maintain, or for the procedures to follow concerning settlement negotiations. Division officials agreed a legal policy/procedures manual is a good idea and will pursue the manual as time permits.

Division Turnover Affects Operations

In the year prior to the start of our audit (fiscal year 1988-89), the Tort Claims Division had turnover in eight of its eleven staff positions; including the assistant administrator, three of the four attorneys, the accountant, an administrative secretary, and two administrative assistants. Because of this turnover, and lack of specific policies and procedures regarding division operations prior to the turnover, the division has been in a period of transition. Many of the deficiencies and weaknesses we noted in our audit findings existed prior to the turnover, and while some still exist, we believe division personnel have been attempting to correct problems.

Chapter II

Division Background

Introduction

The Tort Claims Division of the Department of Administration defends the state against tort actions and provides insurance protection for state government. A tort action is defined as a wrongful act resulting in damages other than contract items. The division investigates claims, defends lawsuits, pays property damage, and bodily injury claims made against state agencies, officers, and employees of the state as provided for in the Montana Constitution and the Tort Claims Act.

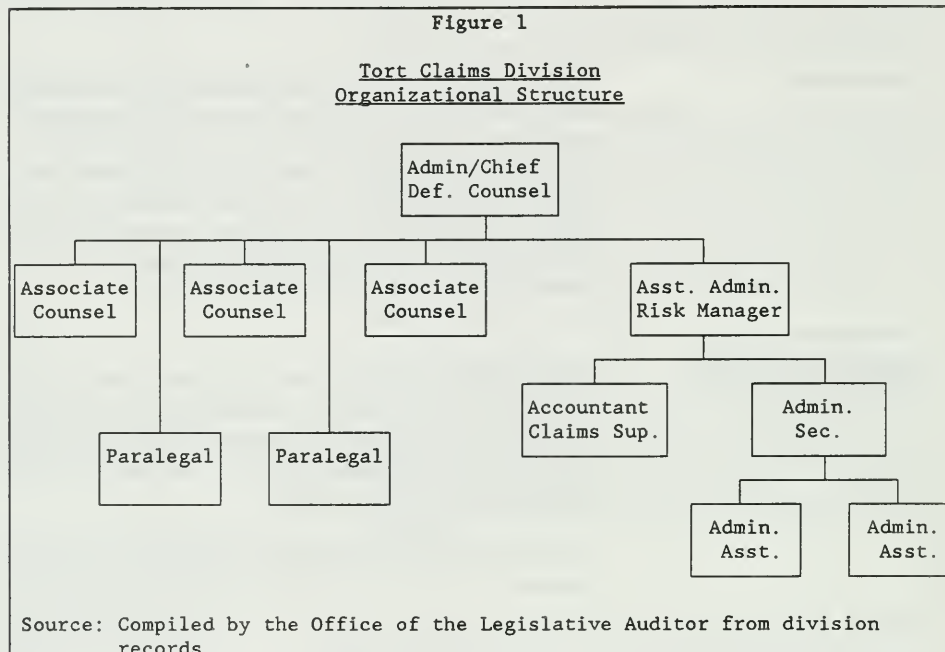
Division Organization

The Tort Claims Division is part of the Department of Administration and during our audit was administered by a division administrator. The division is functionally separated into legal operations and insurance operations. The division has 11 FTE authorized for fiscal year 1990-91.

The following figure displays the organizational structure of the division.

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Division Background



State Insurance Program

A part of the Tort Claims Division's statutory responsibility is development and administration of a comprehensive insurance program for the state. In order to comply with this mandate, the division obtained commercial insurance policies and where commercial insurance was not feasible or cost prohibitive, a self-insurance program was developed.

The division's insurance operation has five people who are responsible for administration of the state's insurance program. During most of our audit they included an assistant administrator/risk manager, an accountant/claims supervisor, an administrative secretary, and two administrative assistants. (The administrative secretary and two administrative assistants also have

responsibilities in the division's legal operations.) The accountant/claims supervisor position has been vacant since June 1990.

The division's insurance responsibilities include the investigation, determination, and payment of claims filed against the state's various insurance coverages by both private individuals and state agencies. The division is responsible for obtaining and evaluating the state's present insurance coverage. The division also works with a private sector organization (Public Risk Insurance Management) regarding commercial insurance. Public Risk Insurance Management (PRIM) provides various services to the Tort Claims Division relative to the division's administration of insurance. Their services include consulting with the division regarding the acquisition/creation of insurance programs and being a liaison between the division and the various insurance companies represented by PRIM. The following sections describe the commercial and self-insurance programs administered by the division.

Commercial Insurance

The state's commercial policies are obtained either through a formal bid process or through quotes from insurance companies. The division solicits bids for those commercial policies which will have a potential premium amount which requires bids under state purchasing laws. For fiscal year 1989-90, the Tort Claims Division purchased approximately \$703,900 worth of commercial insurance. In those cases where a formal competitive bid process is required, division officials obtain quotes from insurance companies, and select the policy based on price and policy provisions such as coverage, deductible, and insurance limit. Division officials often consult with PRIM representatives regarding bid specifications and policy provisions for the commercial policies obtained.

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Division Background

Self-Insurance

The 1972 state constitution eliminated the concept of sovereign immunity. Sovereign immunity protected the state from being sued for actual or perceived wrongs the state could commit. Between 1972 and 1976, the state purchased liability insurance to cover exposures created by the loss of sovereign immunity. The state's self-insurance program was initially created in 1977 because liability insurance became unavailable or unaffordable from the commercial market. Currently, the division's two primary self-insurance policies are liability and automobile insurance. The self-insurance premiums in fiscal year 1989-90 totaled approximately \$2,930,000.

A factor which affects whether the state obtains a commercial policy or self-insures is the degree of risk associated with insuring an activity or entity. For example, although the Tort Claims Division has a commercial insurance policy which covers state property, they established a self-insurance program for houses which have been foreclosed on by the Board of Housing. This policy was established because the existing commercial policy has a \$150,000 deductible, yet none of the houses owned by the board have this high a value. The Tort Claims Division determined commercial insurance for these houses would be more expensive than the risk associated with self-insuring, so a self-insurance program was developed.

Types of Insurance

For fiscal year 1989-90 the Tort Claims Division administered 21 commercial policies and 9 self-insured programs. The following table identifies the various policies, the maximum deductible the state or an agency must pay if filing an insurance claim, and the maximum dollar limit the policy would pay on a single loss.

Chapter II

Division Background

Table 1

Insurance Policies Administered By The Tort Claims Division
Fiscal Year 1989-90

<u>Type of Insurance</u>	<u>How Insured</u>	<u>Maximum Deductible</u>	<u>Maximum Dollar Limit</u>
Liability	Self-insured	\$ 0	\$ 1,500,000
Automobile(liability)	Self-insured	0	1,500,000
Automobile(comprehensive)	Self-insured	50	1,500,000
Automobile(collision)	Self-insured	100	1,500,000
Property	Commercial	150,000	50,000,000
Employee Bond	Commercial	1,000	1,000,000
Boiler	Commercial	500	5,000,000
Helicopter	Commercial	10,000	450,000
Aircraft	Commercial	3,000	1,500,000
Airport	Commercial	0	1,000,000
<u>Miscellaneous Insurance</u>			
Motorcycle-OP1	Self-insured	\$ 0	\$ 2,000
Liquor-Revenue	Self-insured	100	Varies
Foster Care-DFS	Self-insured	100	2,500
Foreclosure-Brd. of Housing	Self-insured	1,000	150,000
Foreclosure-Brd. of Invest.	Self-insured	1,000	150,000
Fine Arts-Historical Society	Commercial	Varies	Varies
Camera-Highways	Commercial	1,000	285,000
Cargo-Highways	Commercial	500	1,100,000
Equipment-Highways	Commercial	500	236,138
Dam Equipment-DNRC	Commercial	25,000	5,000,000
Contractors-Msla.Vo-Tech	Commercial	1,000	157,250
Crime-Treasurer	Commercial	10,000	1,251,000
Employee Bond-Commerce	Commercial	1,000	2,000,000
Cargo-Prison	Commercial	250	10,000
Indemnity-DOL&I	Commercial	2,500	1,000,000
Cargo-Military Affairs	Commercial	100	17,629
Cargo-SRS	Commercial	10,000	Varies
Equipment-MT.Tech	Commercial	1,000	25,000
Crime-MT.Tech	Commercial	0	Varies
Crime-NMC	Commercial	250	Varies

Source: Compiled by the Office of the Legislative Auditor from division records

Deductibles

There are a wide variety of commercial and self-insurance policies administered by the division. The deductibles for commercial policies are established by the division through formal bid specifications or based on availability of commercial insurance. Additionally, the division sets insurance deductibles

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Division Background

for some policies for the agencies. For example, the state property insurance policy has a \$150,000 deductible of which \$149,000 is paid from the self-insurance reserve fund. The remaining \$1,000 must be paid by the agency having the property claim. The division also establishes the deductibles the agencies must pay for all self-insurance policies, including automobile collision and comprehensive deductibles, and the liquor inventory insurance deductibles. The miscellaneous or specialty policies shown are obtained or developed at the request of the applicable agencies because there is no general policy which specifically covers the asset or activity or because the agency has requested the insurance. For example, the general property insurance policy does not insure against theft, so the Historical Society required insurance for their various artworks.

Premiums

Premium costs for commercial and self-insurance are apportioned to various state agencies based on a wide range of factors which change based on the type of insurance. For example, the comprehensive general liability insurance premium is designed to protect state agencies from all types of potential liability including property damage and bodily injury claims. Due to the wide-ranging nature of the protection offered by this insurance, the premium is calculated based on a five factor formula which considers:

1. The agency's appropriations (15%).
2. The agency's FTE levels (12.5%).
3. The agency's claim history (number of claims) since the inception of the formula (12.5%).
4. The dollar amount paid by the division for the agency's past five years claims (50%).
5. The agency's prior year liability insurance premium (10%).

Each factor is designated a percentage of the total premium cost as is shown above in parentheses.

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Division Background

Other commercial insurance policies are apportioned to agencies based on their insured percentage of the total premium. For example, aircraft insurance premiums for the applicable agencies are determined by the number and type of aircraft owned. Other policies consider the activity or entity being insured. The Tort Claims Division relies on the agencies to provide the basic source data used to develop the premium costs for both an aggregate and individual agency basis.

Typically, agencies are billed for insurance costs at the beginning of each fiscal year. The billed amount depends on the types of insurance the agencies have, and by a percentage of the costs of the general policies as determined by the Tort Claims Division. The following table illustrates premiums charged seven state agencies in fiscal year 1989-90.

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Division Background

Table 2

Tort Claims Division
Insurance Premiums Charged to a Sample of State Agencies
Fiscal Year 1989-90

<u>Agency Name</u>	<u>Type of Insurance</u>	<u>Premium Amount</u>
Justice	Liability	\$ 44,037
DFWP	Liability	279,470
Highways	Liability	731,753
Lands	Liability	19,003
Administration	Liability	26,453
Commerce	Liability	41,824
Revenue	Liability	52,824
Justice	Property	\$ 883
DFWP	Property	6,435
Highways	Property	26,288
Lands	Property	3,077
Administration	Property	52,740
Commerce	Property	1,281
Revenue	Property	3,428
Justice	Employee Bond	\$ 1,859
DFWP	Employee Bond	929
Highways	Employee Bond	2,117
Lands	Employee Bond	411
Administration	Employee Bond	1,122
Commerce	Employee Bond	354
Revenue	Employee Bond	3,026
Justice	Auto Fleet	\$ 57,492
DFWP	Auto Fleet	49,874
Highways	Auto Fleet	234,787
Lands	Auto Fleet	70,289
Administration	Auto Fleet	971
Commerce	Auto Fleet	7,385
Revenue	Auto Fleet	19,063
Justice	Aircraft	\$ 1,680
DFWP	Aircraft*	7,206
Highways	Aircraft	4,550
Lands	Aircraft*	4,215
Commerce	Aircraft	3,395

* Does not include helicopters

Source: Compiled by the Office of the Legislative Auditor from division records

Self-Insurance Reserve

The Tort Claims Division provides self-insurance coverage for comprehensive general liability, automobile fleet liability, physical damage and liability coverage for leased and loaned vehicles, and several small exposures with any losses being paid from the self-insurance reserve fund. The division's risk manager works with state agencies to determine whether other agency activities or assets could be self-insured or whether commercial insurance is needed. The decision is partially based on the degree of risk of significant losses to the self-insurance reserve fund. The fund also pays for the general operations of the division and for property loss deductibles established for property insurance. The self-insurance reserve is financed through premiums for self-insurance coverage charged state agencies and earnings on fund assets invested with the Board of Investments.

The adequacy of the fund in terms of its ability to absorb actual and potential losses is evaluated every two years by an actuary hired by the division. The actuary uses division-supplied information on actual and potential losses, as well as nationwide statistics to measure the financial soundness of the fund. The actuary estimated the self-insurance reserve fund would need a fund balance of approximately \$19.3 million to cover potential and actual losses as of June 30, 1990. The state's self-insurance reserve at the time of the analysis was approximately \$6.3 million, resulting in an estimated reserve deficiency of approximately \$13 million.

Claims Administration

In addition to insurance administration, division staff receive and evaluate claims submitted by private individuals and state agencies. Upon receipt of a written claim, the Tort Claims Division determines whether it has sufficient information regarding the claim to determine its validity. The Tort Claims Division requires an incident report from the agency involved. If division staff believe additional validation of the claim or claim amount is necessary prior to making a decision, they either request more information from the claimant or may send

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Division Background

a contracted adjuster to visit the claimant. After determining claim validity, they either send the claimant a denial letter or a release form which specifies the amount of the claim to be paid if the state is released from any further liability regarding the claim. If the claimant agrees with the monetary sum decided upon by the division and signs the liability release, a check is sent and the claim file is closed. If a claimant disagrees with the division's decision, they may continue to negotiate with the division or seek recourse via a lawsuit.

Claims submitted by individuals typically result from perceived or actual damages caused by a state agency which result in personal injury or property damage. Common types of claims are for property damage to vehicles caused by Department of Highway snowplows/sanders or property damage to vehicles caused by traffic accidents in which an agency's vehicle is involved. Claims submitted by state agencies are claims against the insurance they pay for. The most common example of an agency claim is for some type of property damage. In most cases, these involve some act of nature such as cold weather, hail storms, etc. However, there have also been agency claims for damage caused by fires and losses from burglaries. The following tables show the types of claims received in fiscal year 1989-90, the agencies involved, and whether the claims have been resolved or were pending at fiscal year-end.

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Division Background

Table 3

Tort Claims Division
Claims Received in Fiscal Year 1989-90

Agency	RESOLVED			PENDING*	
	<u>Number</u> <u>Claims</u>	<u>Amount</u> <u>Requested</u>	<u>Amount</u> <u>Paid</u>	<u>Number</u> <u>Claims</u>	<u>Amount</u> <u>Requested</u>
Highways	247	\$ 7,048,807	\$ 68,749	20	\$ 3,985,961
University System	71	393,855	124,368	17	304,705
Family Services	16	3,017,120	3,427	7	1,000,769
Institutions	15	4,153,081	11,938	6	627,675
DFWP	13	67,052	4,174	1	2,469
Revenue	12	2,105,718	4,912		250,000
Justice	7	5,058	5,236	5	8,287,390
Labor & Industry	7	255,314	7,009	1	NAS **
Lands	5	12,423	5,867	1	1,200,000
Commerce	4	2,388,220	1,126	0	0
Military Affairs	4	16,952	3,422	0	0
OPI	2	510,000	0	0	0
Agriculture	2	1,175	1,175	0	0
SRS	2	40,641	21,646	0	0
Supreme Court	2	1,712	1,562	0	0
Brd. of Educ.	1	5,000	5,000	1	500,000
Health	1	1,159	159	2	1,470,607
Comm. of Pol. Prac.	1	5,475	4,145	0	0
Governor's Office	1	9,035,185	0	0	0
Administration	1	871	871	0	0
Natural Resources	0	0	0	1	25,000
TOTAL	<u>414</u>	<u>\$29,064,818</u>	<u>\$276,786</u>	<u>62</u>	<u>\$17,654,576</u>

*Pending as of July 1, 1990

**NAS = No Amount Shown

Source: Compiled by the Office of the Legislative Auditor from division records

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Division Background

Table 4

Tort Claims Division
Type of Claims Received in Fiscal Year 1989-90

Claim Type	RESOLVED			PENDING*	
	Number Claims	Amount Requested	Amount Paid	Number Claims	Amount Requested
01-SNOWPLOW/SANDER	71	\$ 38,680	\$ 26,831	3	\$ 2,237
02-MOWER/AIR COMPRESSOR	22	10,886	8,235	2	525
03-POTHOLES	4	623	89	0	0
04-OIL/TAR/PAINT	29	16,434	11,275	1	60
05-ROAD HAZARD/OTHER	52	43,295	11,970	2	41,985
06-COLLISION	59	153,110	69,259	9	100,510
07-PROPERTY-WATER	4	48,883	547	3	5,060
08-PROPERTY-FIRE	3	49,591	48,491	1	250,000
09-PROPERTY-VANDALISM	7	13,222	3,894	0	0
10-PROPERTY-STORM	2	41,785	785	1	12,404
11-PROPERTY-MISCELLANEOUS	27	50,536	25,510	4	30,185
12-BURGLARY	25	44,278	20,547	5	22,866
13-BODILY INJURY	23	339,513	33,416	4	460
14-FOSTER CHILD	7	7,586	1,714	3	769
15-OTHER LIABILITY	29	28,180,648	12,223	24	17,187,515
16-CONST. PROJECTS	50	25,748	0	0	0
TOTAL	414	\$29,064,818	\$274,786	62	\$17,654,576

*Pending as of July 1, 1990

Source: Compiled by the Office of the Legislative Auditor from division records

Issues concerning insurance administration and claims handling are discussed in Chapters III, IV, and V.

Legal Operations

During our audit there were six people involved in the division's legal operations. They included the division administrator who was also the division's chief defense counsel, three attorneys, and two paralegals. Staff involved in the insurance operation also provide support to the legal operation. The major duties of the legal operation's staff are assigned by the division administrator and include evaluation/investigation of claims and the legal defense of the state in lawsuits filed against the state. In June of 1990, Department of Administration officials determined there would be re-organization within the Tort Claims

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Division and the division administrator and chief legal counsel positions would be separated. The division administrator position was filled in November of 1990. Since the division administrator was also the chief defense counsel, the individual was responsible for operation of the division as well as determining who should defend the state against potential and pending legal actions resulting from tort claims.

Due to the number and type of legal actions, the chief legal counsel contracts with private attorneys and the Department of Justice's Agency Legal Services Bureau in addition to using in-house staff for legal defense work. The legal defense work usually arises from private individual claims which are denied or partially denied by the division and the individual files a lawsuit to obtain compensation. All claims must be denied by the division before the filing of a lawsuit in district court. Prior to judicial settlement of a claim, the division may settle any claim; however, a claim settlement exceeding \$10,000 must be approved by the presiding district court judge.

The following table shows a summary of cases closed from July 1, 1986 through January 1990 and the results of those cases relative to who handled the case, and the type of settlements noted. The data was derived from memorandums developed by the Tort Claims Division to show the individual results of legal cases.

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Division Background

Table 5

Tort Claims Division
Management of Legal Cases Closed
For the Period July 1, 1986 Through January 1990

Amount of Award *	Total		Percent of Cases Managed by				
	No.	%	Agency Legal Services	Contract Attorney	Tort Claims	Affected Agency	Comb/ Other
*****	*****	*****	*****	*****	*****	*****	*****
\$0	137	60.6%	18.6%	21.7%	11.9%	3.1%	5.3%
\$2,000 or less	17	7.5%	4.0%	1.8%	1.8%	0%	0%
\$2,001 - 10,000	26	11.5%	2.7%	3.5%	4.0%	.9%	.4%
\$10,001 - 50,000	29	12.8%	3.5%	3.5%	3.5%	.4%	1.8%
Over \$50,000	17	7.5%	2.2%	3.5%	.4%	0%	1.3%
Total	226	100.0%	31.0%	34.1	21.7%	4.4%	8.8%

* Settlement, Jury Award, or Judge Award

Source: Compiled by the Office of the Legislative Auditor from division records

Program Funding

Two funding sources support the Tort Claims Program. Insurance charges assessed state agencies for commercial and self-insurance premiums and interest earnings from the self-insurance reserve account. The program's revenues and expenditures for fiscal years 1988-89 and 1989-90 are shown in the following table.

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Division Background

Table 6

Tort Claims Program
Revenues and Expenditures
Fiscal Years 1988-89 and 1989-90

	<u>FY 1988-89</u>	<u>FY 1989-90</u>
REVENUES:		
Investment Earnings	\$ 578,548	\$ 517,139
Premiums	3,282,855	3,707,711
Insurance Proceeds	1,453,303	40,020
Miscellaneous	0	105
Transfers In (Net of		
Transfers Out)	<u>85,000</u>	<u>0</u>
Total	<u>\$5,399,706</u>	<u>\$4,264,975</u>
EXPENDITURES:		
Personal Services	\$ 284,162	\$ 300,853
Operating Expenses	2,431,745	2,475,232
Equipment	13,553	1,249
Capital Outlay	79,227	0
Benefits & Claims	<u>2,608,783</u>	<u>1,483,439</u>
Total	<u>\$5,417,470</u>	<u>\$4,260,773</u>

Source: Compiled by the Office of the Legislative Auditor from SBAS records

Revenues in the above table include investment earnings from the self-insurance reserve fund, premium collections from state agencies, insurance proceeds from commercial insurance carriers, and interentity transfers from the self-insurance reserve fund. Expenditures include insurance benefits and claims paid to state agencies and individuals.

Chapter III

Insurance Coverage and Agency Billing

Introduction

The Tort Claims Division administers commercial insurance and self-insurance policies for the various state agencies. The following discusses many of the policies examined and improvements which could be made regarding the administration of those policies.

Effect of Source Data On Adequacy of Coverage

The Tort Claims Division is responsible for providing a comprehensive insurance plan for the state. The division uses basic source data obtained from state agencies to determine insurance coverage and calculate insurance policy premiums. Source data includes information regarding the number of employees, number and type of vehicles, property and content lists, etc. During our review of the types and adequacy of insurance coverage, we noted some deficiencies in the source data related to the completeness and accuracy of agency-supplied information. In conjunction with our concerns regarding the adequacy of source data, we determined that, without complete inventories on what an agency has, there is no assurance items missing from the list are insured. Additionally, the division has no assurance state agencies pay their proportionate share of the insurance premiums. The following sections discuss specific deficiencies with the source data and the potential effect on insurance coverage.

Property Coverage

The commercial insurance policy and subsequent premium for property insurance is calculated by the insurance company based on the value of the state's buildings and their contents. Prior to solicitation of bids for property insurance for fiscal year 1990-91, the Tort Claims Division determined the division needed to update the insured property lists and subsequent values which were compiled in 1985-86 by the division's property appraiser. Since the division no longer has an appraiser, division officials relied on the agencies to provide them with new and/or updated data on building and content values. Division staff could not assure buildings and contents which were constructed, acquired,

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Insurance Coverage and Agency Billing

or eliminated since the 1985-86 appraisal, were correctly updated on the property lists. Additionally, the division did not provide any guidelines to the agencies on how the valuations should be performed or what should be included in the updated information. During our agency visits, several agency officials expressed concern about their agency's ability to accurately appraise property values as well as concern about the consistency of appraisal techniques employed by other agencies.

Although the division recognized the potential deficiencies in the valuations, in many cases the division used the submitted valuations in developing a total dollar value for state properties. The insurance company has accepted the updated property listing and subsequent valuations compiled by the Tort Claims Division. However, neither the division nor the state agencies have any assurance the listings or valuations are accurate.

The state's property insurance policy is a blanket policy. The division believes the policy theoretically covers all properties whether or not they are properly valued or included on the property list. However, the division does not have formal assurance the insurance company would fully cover a building and its contents if the final costs were significantly higher than the valuation established for determination of the premium or if the building and/or contents were not on the property list.

Auto Fleet Coverage

The Tort Claims Division relies on the state agencies to submit comprehensive, accurate lists of owned, leased, and loaned vehicles to the division for determination of the agencies' auto insurance liability premium. The division also provides collision and comprehensive insurance for agencies' leased and loaned vehicles. The insurance premium is based on a standard liability rate plus a percentage of the vehicles' value. The vehicles' value is established by the agency. In reviewing the documentation submitted by the agencies and/or developed by the division, we determined the division did not have complete data on agencies' vehicles. In some instances, agencies did not submit complete descriptions of owned vehicles, i.e., vehicle identification

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numbers or license plate numbers. In other cases, agency lists of leased/loaned vehicles did not provide enough information to determine whether some vehicles were still in the agency's possession or whether dollar values established for some vehicles were reliable. As a result of the incomplete information, the division (in at least two instances) billed agencies using the prior year's premium amount (fiscal year 1988-89) rather than using the fiscal year 1989-90 auto fleet information submitted by the agencies.

Due to the inability to fully verify some agencies' vehicle lists for fiscal years 1988-89 or 1989-90, the division cannot assure agencies paid their appropriate insurance premium. The division recently developed a Montana Operations Manual (MOMs) policy on auto fleet insurance which is designed to improve agency-submitted vehicle lists and subsequently its ability to assure insurance coverage for all vehicles in the future. Prior to completion and distribution of the new policy, the division did not have formalized procedures in place to verify complete insurance coverage for all state vehicles.

Summary

Lack of complete and accurate source data upon which to determine insurance premiums, and ultimately the amount of insurance each agency should carry, compromises the division's ability to provide comprehensive insurance coverage. Potentially, there are some state assets which may not be covered. Additionally, without adequate source data upon which to refer, neither the Tort Claims Division nor individual agencies can confirm the accuracy of insurance premiums assessed by the division.

We believe the Tort Claims Division should establish specific criteria for the nature and type of source data to be submitted by the agencies. The division should require the agencies to provide data which is consistent and verifiable. Secondly, the division should establish formal procedures to review the reasonableness of the source data submitted by state agencies.

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These procedures could include using the Property Accountability Management System (PAMS) to obtain data on current agency assets. The division could then compare and confirm the PAMS listing of assets to the data supplied by the agency. If this type of data was compiled for all property and auto policies, the division would be better able to develop supportable insurance premiums and assure all agencies are insured and subsequently billed appropriately.

Recommendation #1

We recommend the Tort Claims Division:

- A. Establish specific requirements for agency submittal of information on insurable items.**
- B. Initiate procedures to compile and check for the reasonableness of the source data submitted by the state agencies.**

Incorrect Billing for Commercial Insurance Coverage

We reviewed the division's billing of state agencies for insurance premiums. Our review of insurance policies and the subsequent billing of agencies for the premiums for those policies revealed agencies were not always correctly charged. By statute (section 2-9-202, MCA), the division is to apportion the costs of all insurance purchased to the individual state agencies. We believe the examples of incomplete or improper billing for commercial insurance discussed below indicates the division needs to establish formal policies and procedures to standardize the billing methodologies and assure compliance with state statute. The noted instances occurred during a period of significant turnover within the division and the new personnel may not have been aware of the proper billing procedures. Division officials indicated procedures will be established to prevent the types of problems noted.

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Insurance Coverage and Agency Billing

Property Insurance

A review of billing for property insurance for fiscal years 1988-89 and 1989-90 indicated a number of agencies were not billed. For example, after the state took temporary possession of the Tobin Mansion in 1989, the Tort Claims Division included the mansion on the property lists. According to division records, the Secretary of State's office was to be billed for the property insurance until the mansion's status as a state property was determined. Our review of the division's fiscal year 1989-90 billing records indicated the Secretary of State was not billed for the mansion's property insurance as had been arranged. A review of other property insurance for fiscal year 1989-90 also indicated neither the vocational-technical centers nor the Department of Family Services were billed for property insurance at the time of our review. Subsequent to receipt of our findings regarding the billing of property insurance, the division billed the vocational-technical centers and Department of Family Services for their property holdings.

Aircraft Insurance

The Tort Claims Division did not proportionally bill the aircraft insurance premium to all agencies. The Governor's Office was not billed for the insurance premium on the Governor's new plane. Rather, the \$4,108 premium was paid out of the Tort Claims Division general operating account. Also, the \$550 cost for additional coverage which was placed on the state's planes was not charged back to the agencies. After being informed of our findings, the division billed the Governor's Office and moved the expenditure to the proper account. However, the Tort Claims Division paid the \$550 premium for the additional coverage from the self-insurance reserve.

Helicopter Insurance

Our review of the state's helicopter insurance noted the Department of Fish, Wildlife and Parks requested insurance on a specific helicopter and then later decided the helicopter was inoperable. As a result, they asked that the helicopter be removed from the policy and requested a refund. Due to the lateness of the agency's request, the insurance company charged

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Insurance Coverage and Agency Billing

the Tort Claims Division \$314 for lack of proper cancellation notice and reduced this amount from the refund. However, the Tort Claims Division did not reduce a corresponding amount from the agency's refund. As a result, self-insurance reserve funds were used to pay for an agency-caused cancellation penalty.

Employee Bond Coverage

To determine the premium paid by the agencies for employee bond coverage, each agency submits to the Tort Claims Division a list of employees classified by the degree of risk each employee has relative to money and property handled.

Our review of fiscal year 1989-90 billing data revealed the vocational-technical centers, Board of Regents, and the Department of Family Services were not billed for an employee bond. Additionally, other agencies were underbilled based on the number of employees shown in the division's records versus our comparisons of other sources of agency FTE levels.

Recommendation #2

We recommend the Tort Claims Division develop and implement procedures to assure all agencies are billed for their portion of commercial insurance premiums.

Inadequate Documentation of Self-Insurance Premium Development

All self-insurance premiums are apportioned to state agencies by the Tort Claims Division on the basis of division-established premium formulas. For fiscal year 1989-90 there were several insurance policies for which the division did not have formal support to document premium development.

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General Liability Insurance

To establish the total liability insurance premium for the state, the Department of Administration works with the Governor's Office of Budget and Program Planning. The premium development takes into consideration previous year premiums, liability losses, and the self-insurance fund balance. The general liability insurance premium is then apportioned to the agencies based on a formula which is intended to represent the agencies' liability risk.

The Tort Claims Division uses a five factor formula which was designed to represent the factors which are most likely to portray how much liability insurance an individual agency should pay. The formula (which is described in detail on page 10) has two factors which constitute 62.5 percent of an agency's premium: an agency's claim history and the five year claim loss. During our audit period, the division was unable to provide verifiable information on the source of the numbers used in either establishing how the total premium is calculated or the claim history and claim loss factor portions of the total formula used to establish fiscal year 1988-89 or 1989-90 premium amounts. Without the information source, we were unable to ascertain the accuracy of the numbers used in developing the premiums. Additionally, without the claim and loss histories, the division was not readily able to prepare fiscal year 1990-91 premium rates or establish estimates of rates for the 1992-93 biennium. Ultimately, the division chose to try and re-create a history for claims and losses by using information from various sources. Our review of the re-creation efforts indicates that while the information developed by the division may have been the only feasible option, there is still no assurance the loss and claim histories are accurate. As a result, there is no assurance the premiums developed for liability insurance fairly represent each agency's share of the state's liability risk.

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Auto Fleet Insurance

Our review of the factors used to develop the auto liability premium indicates the division does not have any formal documentation to support the individual unit rates which determine the cost per vehicle on state-owned vehicles. Division personnel have not evaluated the rates charged for auto insurance since their creation five years ago. The following table shows the auto liability insurance unit rates paid by state agencies.

Table 7

Tort Claims Division
Auto Fleet Liability Insurance Unit Rates
Fiscal Years 1986-87 through 1990-91

<u>Type of Unit</u>	<u>Annual Unit Rate</u>
Passenger Cars	\$177
Light Trucks	91
Buses	246
Medium Trucks	86
Heavy Trucks	110
Motorcycles	96
Commercial Trailers	24
Snowmobiles, etc.	67
Utility Trailers	2
Miscellaneous	2

Source: Compiled by the Office of the Legislative Auditor from division records

Additionally, because the division does not have complete, up-to-date information on state automobiles (as noted on page 22), it did not adequately support or verify all the premiums charged to state agencies in fiscal year 1989-90. Although division officials have acknowledged the auto rates need to be evaluated, they used the existing rates to establish auto premium estimates for the 1992-93 biennium.

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Insurance Coverage and Agency Billing

Liquor Inventory Insurance

The Tort Claims Division provides insurance to the Department of Revenue's Liquor Division for liquor inventories in the various liquor stores. The self-insurance premium is determined by averaging the value of liquor store contents for the prior 12 months and then multiplying this by a numerical factor to establish the premium amount. Our review showed the division has insufficient documentation to support the premium charged for this insurance. For fiscal year 1989-90, the Department of Revenue was charged \$11,240 for liquor inventory insurance, yet neither Revenue officials nor Tort Claims Division personnel know how the numerical factor or average liquor values for the premium formula were established. Prior to employment of either current Tort Claims Division or Liquor Division officials, the two divisions developed a formula to establish liquor inventory value, yet neither division has any documentation which details how the formula was developed or whether the factors within the formula are still valid.

Summary

Overall, there is limited support for the self-insurance premiums set by the division. There is no assurance the premiums established appropriately consider the risk associated with the coverage provided. As a result, there are two potential concerns:

1. Losses associated with those policies may be unnecessarily lowering the self-insurance reserve.
2. The agencies may be paying more or less for insurance than necessary.

The above examples of insufficient support and/or documentation for insurance premiums are for insurance policies which were established prior to the employment of current staff. As a result of limited time to analyze and/or alter the factors used to initiate premium development, division personnel have not been able to evaluate or support many of the factors used in insurance premium development. We believe the division should evaluate and formally support the self-insurance premium development factors as a division priority, in order to help

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Insurance Coverage and Agency Billing

preserve the self-insurance reserve and accurately reflect the costs of self-insurance administered by the division.

Recommendation #3

We recommend the Tort Claims Division evaluate and establish formal support and documentation for self-insurance premium development.

Late Billing

The policy terms for the state's insurance, both commercial and self insurance, generally begin July 1 each year and end June 30 the following year. Typically, state agencies would be billed for their insurance premiums shortly after the beginning of the new fiscal year. However, for the last two years (fiscal years 1988-89 and 1989-90) the division has not completed agency billings for insurance until the last few months of the fiscal year. During fiscal year 1989-90, the Tort Claims Division did not start billing for auto insurance until February 1990, and by the beginning of March 1990 the division still had not billed agencies for auto insurance on leased/loaned vehicles. We also noted late billing for agency property holdings as well. Division personnel indicated the billing process has been slowed due to staff turnover and time available to do prompt billing, as well as delays in the development of a new MOMs policy for auto insurance.

When late billing occurs, the Tort Claims Division must use funds from the self-insurance reserve until it collects insurance premiums from the agencies. When reserve funds are not in use, the money is invested to help increase the self-insurance reserve. By using reserve funds to pay for expenses prior to receiving agency insurance premium payments, the Tort Claims Division decreases the amount of interest on investment earnings. For example, the total billing for auto fleet insurance for

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fiscal year 1989-90 was \$650,248. Since the division did not promptly bill the agencies, the self-insurance reserve fund lost approximately \$28,000 in interest earnings. This calculation is based on the assumption agencies would have paid auto insurance in September/October versus April/May. Therefore, the reserve fund lost approximately six months of interest earnings at the annualized Short Term Investment Pool yield rate of 8.69 percent for fiscal year 1989-90. The Tort Claims Division should implement a more timely insurance premium billing process to maximize interest earnings for the self-insurance reserve fund.

Recommendation #4

We recommend the Tort Claims Division ensure premium billing is done in a timely manner.



Chapter IV

Risk Management

Introduction

Risk management encompasses such functions as analysis of insurance policies and coverages, loss prevention, claims management and risk identification. Based upon information obtained from the Tort Claims Division a risk manager should inspect properties, review capital construction funding requests, develop a risk management policy and a manual for performing risk management, and establish dollar amounts for direct and indirect loss potentials. Additionally, a risk manager is to supervise claims administration, negotiate insurance, keep records, administer risk functions and oversee loss prevention activities. These functions include the examination and evaluation of the benefits and/or drawbacks of commercial and self-insurance policies.

In order to perform some of the above functions, the Tort Claims Division in early 1989 established a combination Assistant Administrator/Risk Manager position. Since development of the position, the division's risk manager has been involved in the analysis and acquisition of new commercial policies as well as making determinations of whether particular state agency activities and assets could best be insured through commercial policies or self-insurance policies. Specifically, the risk manager has initiated specialized self-insurance programs for the Office of Public Instruction's motorcycle training program, the Board of Housing's and Board of Investment's foreclosure properties, and the Department of Family Service's foster parents' program.

Need for Additional Risk Management

In "Practical Risk Management," a handbook used by the division's risk manager, there is a guideline to demonstrate how much time/money should be allocated to risk management based on insured losses, uninsured losses, and insurance premiums. Based on numbers supplied by division personnel and the formula noted in the handbook, the division should have an approximate annual budget of \$300,000 dedicated just to risk management. However, at present the division has less than half

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Risk Management

an FTE organizationally assigned to risk management. Our interviews indicate risk management efforts likely represent less than one-fifth of the assistant administrator/risk manager's time in any given pay period. This represents an annual expenditure of approximately \$7,500 in division resources for risk management.

Based on interviews with division personnel and our audit work we do not believe the Tort Claims Division has had the time or resources to develop or establish a comprehensive risk management strategy. Currently, the division does not have a formalized risk management plan nor has the risk manager been able to do any statewide evaluation of the state's potential risk areas in relation to current insurance coverage. This is partially evidenced by our audit findings regarding lack of support and documentation for the current insurance premiums, insufficient historical data on buildings and vehicles, and inadequate loss statistics.

We also noted an additional indicator of the limited risk management/loss prevention activities being performed by the division relative to inspection reports. A review of division files revealed the commercial carriers for property and boiler insurance submit inspection reports to the division recommending building and/or boiler changes to improve the insurability of the state's properties. The division has no formal procedures to follow up on the report recommendations and there has been relatively little informal follow-up performed. Follow up on the inspection reports would be a good example of the type of active risk management necessary to prevent potential losses and assure the continued insurability of state properties.

There are several reasons why the Tort Claims Division does not have an active risk management function. Prior to addition of a risk manager, the division concentrated on the administration of the various insurance policies and claims, and not risk management. Current reasons include significant staff turnover which has required the assistant administrator to focus on recruiting and hiring new staff. Additionally, the assistant administrator is

functionally responsible for various other administrative duties including budget development, acquiring insurance, and monitoring claims administration.

We believe the Tort Claims Division should place additional emphasis on risk management by establishing a risk management plan and allowing the risk manager to actively pursue risk management strategies. Division officials agree a risk management plan should be formulated and have indicated they believe more time will be available for risk management in the future.

Recommendation #5

We recommend the Tort Claims Division develop and implement a formal risk management process.

Evaluation of Insurance Policies

As part of the Tort Claims Division risk management procedures, the division should annually review and analyze all insurance policies from a cost/benefit perspective as well as from a risk basis. This would help determine the need for current and future insurance policies and the extent of insurance coverage required, and would establish whether commercial policies could be self-insured to potentially reduce costs relative to overall risk. The following sections discuss areas of concern regarding insurance policies administered by the division.

Self-Insurance Versus Commercial

At the request of various state agencies, the Tort Claims Division obtains commercial insurance policies or self-insures equipment, houses, motorcycles, etc. which are not specifically covered by other insurance policies. We reviewed these specialty policies to determine the reasons for the insurance and subsequent cost. The review noted a commercial insurance policy was obtained at the request of the Department of

Chapter IV

Risk Management

Highways to insure some highway paving test equipment. The equipment is kept in trailers and moved between job sites. There are 11 trailers in all, and the equipment in each trailer costs \$9,500 for a total of \$104,500. Our review of this policy indicated the state pays \$1,635 for a maximum insurable value of \$236,138. When we asked about this policy, division personnel did not know why the maximum is more than twice the actual value of the equipment.

As a result of the Tort Claims Division not reviewing (or not documenting the review of insurance policies), the agencies responsible for paying the premiums may be paying more for insurance than necessary. For example, the Department of Highways policy has a maximum insurable value of over twice the equipment's value. In addition, because the test paving equipment is in 11 separate trailers, the risk of a complete loss appears to be remote. Tort Claims Division officials stated they could not see any preliminary problems with self-insuring this type of equipment, but they have not had time to evaluate many of the specialty commercial policies. Additionally, division personnel did not know why other agencies' special equipment was not insured. One example would be the test kits and provers used by the Weights and Measures Bureau at the Department of Commerce. Another example of relatively expensive assets which are not covered are portable computers which are not insured for theft or damage while in automobiles.

Insurance Deductibles

Although division personnel evaluate the major insurance policies, there is no documentation to demonstrate whether the division considers such loss variables as deductible amounts versus potential effect on the self-insurance reserve. For example, the division has no formal documentation to support its current deductibles of \$50 for comprehensive and \$100 for collision on leased/loaned vehicles or why a \$100 deductible is used for liquor inventory insurance claims. Additionally, the division cannot demonstrate whether it would be better to increase the \$1,000 deductible for agencies' property insurance in light of the large number of property claims. Also they

should be able to readily show whether the division should attempt to lower costs by considering the addition of a deductible (for example) for helicopter or airplane insurance based on the minimal loss claims related to these policies.

Summary

We believe the Tort Claims Division should, as part of its risk management activities, establish a formal review procedure for all insurance policies. The review should include analysis of current costs, claim histories and evaluation of deductibles. This would help determine whether the risk and cost associated with policies justify the current status, whether it be a commercial or self-insured policy. Division officials agreed the insurance policies should be analyzed on a regular basis and have proposed a biennial analysis.

Recommendation #6

We recommend the Tort Claims Division establish a formal insurance policy review process to evaluate the cost/benefits of the various policies.



Chapter V

Insurance Administration

Introduction

The Tort Claims Division is responsible for administration of the state's insurance programs. In some cases, they have obtained commercial insurance to protect the state's assets, and in others a self-insurance program was established. In both instances, the insurance was obtained/developed based upon various risk management factors identified and evaluated by the division. The factors include risk, extent of coverage required, potential effect on the self-insurance reserve, etc. The following sections discuss two risk management factors which affect the division's ability to properly administer the state's overall insurance program.

Agency Acquisition of Commercial Insurance

During our audit we selected 17 agencies from a list of state agencies which had expenditures for insurance and bonds in fiscal year 1989-90. We visited each of these agencies to determine the types of insurance they have and to establish whether the policies were administered by the Tort Claims Division. We found 7 of the 17 agencies had one or more policies in effect for fiscal year 1989-90 which were not obtained by the Tort Claims Division and are not administered by the division. The total premium cost for these policies was \$88,278.

Section 2-9-201, MCA, states the Department of Administration is responsible for the acquisition and administration of all insurance purchased for the protection of the state. At a minimum, this statute suggests all agencies should formally consult with the Tort Claims Division prior to obtaining any type of insurance. Tort Claims Division officials indicated they are aware state agencies have obtained insurance, but are unaware of the number and/or types of insurance policies. Because the agencies did not consult with the Tort Claims Division regarding their perceived needs, there is less assurance the agencies obtained the correct coverage or they are paying the lowest potential premium.

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Insurance Administration

Our review of the agencies' policies indicate there are a number of policies which may duplicate insurance coverage already purchased or provided by the Tort Claims Division. For example, the University of Montana and Montana State University in fiscal year 1989-90 carried commercial insurance on the university presidents' home and car, both of which are covered by policies administered by the Tort Claims Division.

While statute requires agencies to have the Department of Administration obtain insurance, our agency visits indicated some agency personnel were unaware of the statute. At other agencies, personnel stated the Tort Claims Division does not provide adequate information on what insurance coverage the agencies have through the state's established policies. As a result, agency personnel indicated when they are not sure whether particular activities or assets are covered they independently obtain their own insurance coverage to reduce potential liability concerns. Consequently, there is little or no consideration of whether the policies duplicate existing coverage, or whether the insurance provides adequate coverage. Finally, some agency personnel indicated they had contacted the Tort Claims Division about providing insurance, but found either the division could not meet their time-frame for obtaining the insurance, or they had more flexibility dealing with a local insurance agent.

State law requires a centralized insurance administrator for all the state's coverage, and therefore the Tort Claims Division should be consulted prior to any agency obtaining insurance. Consequently, we recommend the Tort Claims Division develop and communicate policy on the subject of insurance administration which emphasizes the statutory responsibility of the agencies regarding acquisition and administration of insurance. Based on interviews with agency personnel, the Tort Claims Division should also develop and distribute to all agencies some type of insurance portfolio which generally describes what is and is not covered by the insurance policies administered by the division. Additionally, the division should provide the agencies with formal assurances they will work with the agencies

regarding whether the existing coverage is adequate relative to infrequent and/or special circumstances which may require insurance. Division officials have stated they will develop and distribute a management memorandum to agencies on insurance procurement and administration procedures.

Recommendation #7

We recommend the Tort Claims Division:

A. Communicate the statutory requirement for centralized insurance administration to all agencies.

B. Develop and distribute more detailed information to state agencies on acquisition of insurance.

**Self-Insurance Reserve
Management**

The Tort Claims Division does not have a formal plan to either make the self-insurance fund actuarially sound or as an alternative, a plan to enhance or protect the existing balance. Based on the Tort Claims Division's most recent quarterly activity report and the 1990 actuary report, the self-insurance reserve fund would need a fund balance of approximately \$19.3 million to cover potential and actual losses. The actual fund balance as of June 1990 was approximately \$6.3 million. This leaves a reserve deficiency of approximately \$13 million. The self-insurance reserve has steadily decreased over the past several years, losing approximately \$3.8 million dollars in five years, not including lost interest earnings. The following table shows self-insurance reserve fund activity for the past five fiscal years.

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Insurance Administration

Table 8

Tort Claims Division
Self-Insurance Reserve Fund Activity
Fiscal Years 1985-86 through 1989-90

<u>Fiscal Year</u>	<u>Fund Balance</u>	<u>Premiums</u>	<u>Earnings</u>	<u>Claims/ Benefits</u>	<u>Transfers Out</u>	<u>Fund Balance</u>
1985-86	\$ 8,218,036	\$3,110,444	\$715,472	\$1,404,794	\$ 447,739	\$10,191,419
1986-87	10,191,419	2,428,597	632,668	5,426,107	849,073	6,977,504
1987-88	6,977,504	3,414,004	627,085	3,100,156	945,000	6,973,437
1988-89	6,973,437	3,896,474	578,549	3,396,219	1,933,999	6,118,242
1989-90	6,118,242	3,710,748	516,504	2,120,361	1,900,000	6,325,133

Source: Compiled by the Office of the Legislative Auditor from SBAS records

The actuary reviews the self-insurance reserve and insurance losses to project or estimate the state's liabilities. The division had to re-create loss histories because detailed records of prior year loss claims had not been adequately documented. The 1990 actuary report stated their estimates are subject to a great amount of variability, partly due to the "lack of case reserve history and problems associated with the underlying data base." The actuary report should be used as the impetus to establish a plan for either matching the fund balance with the potential liability or indicating what level of reserve should be maintained to at least minimally protect the state against estimated liabilities.

As noted, the self-insurance reserve fund has been steadily decreasing over the past several years. Four of the contributing reasons for this decline include:

1. The Tort Claims Division is not including all or even a portion of the division's costs for administering the various insurance programs in the development of premiums.
2. The Tort Claims Division has not included inflation factors for insurance premiums to protect the current reserve or ensure an increasing reserve.

3. The Tort Claims Division has not analyzed or changed its insurance rate formulas for several years relative to losses especially property losses under the deductible amount for property insurance.
4. The Tort Claims Division has not formally addressed the self-insurance reserve deficiency from the perspective of what is an "acceptable" deficiency.

Section 2-9-202, MCA, provides the division with authority to establish insurance premiums which would take into consideration administrative costs and protection of the reserve. These additions would help decrease the loss of self-insurance reserves.

At present, the state's self-insurance reserve may not be adequate to pay significant liability losses based on the actuary's report. As a result, the Legislature would have to seek alternative solutions to pay for losses above and beyond what is in the reserve fund. Without a plan and/or active management of the self-insurance reserve, we have no assurance the reserve fund will be adequate.

We believe the Tort Claims Division should establish procedures to fully develop the loss statistics required by the actuaries to provide more accurate estimates of ultimate liabilities. The division should then use the actuarial information to establish a formalized plan regarding the self-insurance reserve fund. This plan should include procedures for the active management of the self-insurance reserve relative to existing insurance policies, premiums, and risk. Division officials have stated the actuarial soundness of the fund is one of the primary objectives of the division, but indicated they must work with the Governor's Office of Budget and Program Planning to determine what the insurance rates should be and the subsequent amount of the reserve fund.

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Insurance Administration

Recommendation #8

We recommend the Tort Claims Division increase its evaluation and management of the Self-Insurance Reserve Fund by:

- A. Developing more comprehensive loss statistics.**
- B. Establishing a plan for sustaining the Self-Insurance Reserve Fund on an actuarially sound basis.**

Chapter VI

Claims Administration and Legal Operations

Introduction

The Tort Claims Division is responsible for processing claims submitted by state agencies and private individuals. Additionally, the division is responsible for defending the state against tort actions. Our review identified improvements which could be made regarding: documentation of division actions, payment and monitoring of contract attorneys, and the division's policies and procedures.

Need for Improved Documentation

During our review we noted areas where the Tort Claims Division should increase the amount of documentation developed and maintained which describes the division's actions concerning claims, settlements, contract attorney selections, and legal staff workload.

Claim Documentation

We reviewed 50 percent of the paid and denied claims filed with the Tort Claims Division from July 1, 1986 to March of 1990. Our review of the claims files indicated the division does not adequately document the decision-making process used to either deny or pay a claim. For example, in the denied claim files there is wide variation and inconsistency regarding the documentation in individual files of why a claim was denied. Although the file and subsequent denial letter sent to claimants by the division may include information which provides the reader with a "sense" of why the claim was denied, there is little or no specific documentation to adequately support or explain why the claim was denied.

The review of paid claims files also revealed inconsistencies in the documentation included in the files. Although we could determine the dollar amount paid to the claimant, the files did not contain specific documentation indicating why a particular dollar amount was selected as the claim payment amount. To compound the concern, there was inconsistency in the amount of documentation used to make the claim payment determination. For example, while many claims were paid based on the lowest

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of two estimates, we found 8 percent (7/88) of the paid claims reviewed only had one estimate. Also, there were several claims paid on the basis of bills submitted by either the claimant or an insurance company with no documentation to support the bill amount.

As a result of the division not having sufficient documentation in the claims files, it was difficult to assess whether the division properly handled claims in terms of its decision to pay or deny individual claims. The reason for the lack of documentation and/or inconsistent documentation appears to be the division does not have formal guidelines or extensive policies which outline what basic information should be included in a claims file. The Tort Claims Division should develop specific policies and procedures regarding the necessary documentation to be included in all claims files and this documentation should be consistent. Improved documentation would provide reference for anyone reviewing the claim to ascertain the reasons for the determination, should the claim re-appear and/or become a lawsuit. Division officials have agreed to increase the documentation in claims files to support their decision-making process.

Documentation of Settlements

Individual claimants not satisfied with the Tort Claims Division's decision regarding a claim can seek legal recourse via the courts. Initially, all claims against the state must be presented in writing to the division and may not be filed in district court unless the division has denied the claim. Prior to judicial determination of a claim, the division may reconsider the claim based on new information and/or negotiation and settle any claim. However, a settlement exceeding \$10,000 must be approved by the presiding district court judge.

The Tort Claims Division does not formally document how dollar amounts of settlements are established or what factors are considered when the division decides to settle a case rather than going to trial. Interviews with the division administrator indicate settlements are usually based on conversations/negotiations with the opposing attorney handling the case, damage costs,

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Claims Administration and Legal Operations

conferences with the department director, etc. The chief legal counsel has a great deal of personal discretion in establishing the size of settlement amounts and oversight is limited to judicial review only if the settlement amount is over \$10,000.

The Tort Claims Division is a public agency which expends public funds to pay claims lodged against the state. Expenditure of those funds should be accounted for by adequately documenting the reasoning behind all claim payments and settlement amounts. Specifically, we believe all case files maintained by the division should include documentation which details how it was decided to settle a case versus going to trial, and what factors were used in establishing the dollar amount paid to the plaintiff. For example, if the decision to settle was based on the fact the state was clearly liable and going to trial could potentially cost the state significantly more than what the claimant was asking, the documentation should detail the reasoning and potential costs. If a settlement is proposed and agreed to, the Tort Claims Division should have documentation detailing the factors used to determine the settlement amount. For example, is the decision based on medical and legal costs, precedents, settlement amount requested, etc.?

The division administrator indicated he does not specifically document settlement determinations because they would be of limited usefulness to the division and because any settlement amounts over \$10,000 are subject to judicial approval. Additionally, the division believes the existing court documents (which are public) provide sufficient information on court settlements and that any additional detail regarding settlement decisions could compromise the state's negotiating position in other cases. While we agree the division should not compromise their negotiating position in documenting settlement agreements, we believe the Tort Claims Division should more formally document settlement details to provide both the division and the public with justification for how public funds are expended.

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Claims Administration and Legal Operations

Recommendation #9

We recommend the Tort Claims Division:

- A. More clearly document the reasons used to pay or deny tort claims.**
- B. More fully document decisions regarding settlement amounts.**

Contract Attorney Selections

According to a division report on contracted services, over one million dollars was expended on contracted legal services in calendar year 1989. The Tort Claims Division has no formal policies or procedures regarding the selection of attorneys who represent the state in tort actions. The division administrator stated the decision (which is typically made by the administrator) to use in-house, Department of Justice Agency Legal Services (ALS), or contracted counsel is based on the type of case, staff workload, geographic location, etc. However, there is no formal documentation of how the selection of an attorney to represent the state is made. In addition, the division administrator's selections are not currently subject to formalized oversight by anyone in the Department of Administration or by the Legal Services Review Committee (LSRC). The LSRC was created to review state agency decisions regarding the need for contracted legal services. The committee is made up of the Budget Director, the Governor's Chief Legal Counsel, and the chief of the Department of Justice's Agency Legal Services Bureau. The role of the LSRC regarding the Tort Claims Division selection of contracted attorneys has not been formally established, and as a result the committee has not been routinely involved with the division administrator's attorney selections.

We believe selection of attorneys should be documented in order to justify selection choice and rate of pay received (the rate of

pay varies from \$25 to \$125 per hour). Without documentation of the justification for attorney selections, it is difficult to determine whether the division's options for defense counsel are being used appropriately. The expenditure of public funds require sufficient documentation to show the decision to select a contract attorney was in the best interest of the state. The documentation should be specific enough to ascertain why a particular attorney was selected. If an ALS or contracted attorney is selected, the documentation should explain why an in-house attorney was not used, and the reasons for selection of the attorney used, i.e., expertise, track record, geographic location, etc. The documentation should also explain whether the attorney selected was the primary or alternate choice and what other persons or firms were considered. Division officials have indicated they are preparing a system to comply with this recommendation.

Recommendation #10

We recommend the Tort Claims Division establish documentation detailing the reasons for attorney selections.

Monitoring of Contracted Attorneys

Attorneys retained by the Tort Claims Division sign contracts which specify their obligations to the division as well as their rate of pay. Our evaluation of the expense documentation submitted by the contract attorneys revealed the Tort Claims Division administrator who initially selects the attorneys also approves payment of their expenses. Additionally, while our analysis of the bills submitted by the attorneys show they typically break their bills down by time spent to complete various tasks, there was little or no evidence of receipts for other expenses with the bills. For example, there were few receipts for such things as airline travel, rental cars, copy services, etc. even though the division was charged for such expenses.

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Claims Administration and Legal Operations

A good system of internal control suggests separate people be responsible for the selection and subsequent payment of contracted attorneys and supportable documentation for monetary transactions. The selection and payment processes should be independent of one another to help assure there is no conflict of interest and to strengthen internal controls. Although the division administrator/chief legal counsel (who is the liaison with contracted attorneys) is in the best position to analyze bills submitted by the contracted attorneys, without some type of formal oversight over his approval or a separate approval authority, neither the department nor anyone else has assurance the payments are appropriate.

The contracts used by the division to specify the obligations of the contract attorney and the subsequent rate of pay states: "the bill for expenses incurred shall be supported by proper documentation, such as copies of receipts attached to the bill." However, our review indicated that of the 55 invoices examined, approximately 90 percent did not include any type of supporting documentation such as receipts. Additionally, the contract states payment shall be on a monthly basis after submission of a bill for services and expenses. We noted the division allows contract attorneys to submit bills on a monthly, bi-monthly, and even quarterly basis for payment. Division officials have stated monthly billing is not required because in many cases there is little or no activity in a case during some months. As an example, there is a case which has been pending for over five years, but the division has only been billed once or twice during the period, because the case has not been actively pursued by the plaintiff. Approximately 60 percent of the bills reviewed were for two or more months worth of legal work. Because the contracts are open-ended in terms of the total dollar amounts to be paid and the average hourly rate charged for legal services was over \$79 per hour, the division should closely monitor these payments.

Contract administration could be improved by requiring all contract attorneys to bill monthly when there is active on-going

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services being provided, and to submit receipts for their expenses. We also believe the Department of Administration should designate someone of equal or greater authority than the chief legal counsel to approve contract attorney payments in order to separate the selection and payment processes.

Recommendation #11

We recommend the Department of Administration:

- A. Separate the attorney selection and attorney payment approval functions.**
- B. Improve contract administration related to contract attorneys.**

In-House Attorney Workload

One of our audit objectives was to determine if division operations were managed economically and efficiently. The Tort Claims Division does not currently track the amount of time spent by in-house attorneys on individual cases. Based on interviews with the division administrator, neither the division administrator nor the three other in-house attorneys are currently required to keep track of time spent on claims/cases they have been assigned. As a result, it is difficult to evaluate staff workload and/or accurately establish costs for cases handled by in-house staff.

The Tort Claims Division spent over one million dollars for contracted attorneys in calendar year 1989, even though the division has four attorneys. The issue of whether additional in-house attorneys are needed was discussed during the last legislative session. No additional attorney positions were approved. Without documentation of the workload of the in-house attorneys it is difficult to determine whether the division needs more attorneys.

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Lack of workload information also inhibits the division in documenting defense costs on a case-by-case basis. In selected circumstances the division can obtain reimbursement from a claimant for legal costs incurred for defending the state against frivolous claims or claims where the state is not liable. At present, the division either estimates the cost of legal services based on the in-house attorney's salary and benefits, or uses an arbitrary figure established by the charges a similarly experienced attorney in the community would charge.

According to the division administrator, a comprehensive workload tracking system has not been implemented because a form to detail the information has not been perfected and because of limited clerical help to input and compile the data. However, an interview with the Chief of the Department of Justice's Agency Legal Services Bureau revealed they have a computerized tracking system which is completed by the individual attorneys, and automatically updated monthly to aid in their billing of agencies for legal services. Additionally, our review of the contracted attorney's billing methodologies appear to indicate some or all have computerized procedures for tracking staff workload.

We believe it is important for the Tort Claims Division to document and track the workload of in-house attorneys in order to develop management information which can be used in a variety of ways including determining staffing decisions and assessing the costs associated with defending claims against the state.

Recommendation #12

We recommend the Tort Claims Division compile and maintain data on staff attorney workload.

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Claims Administration and Legal Operations

Policies and Procedures

Throughout the audit of the Tort Claims Division we identified routine division activity which was not standardized and/or governed by formal policies and procedures. The following sections identify some of the more significant division operations which we believe could be improved by formalizing and standardizing division policies and procedures.

Claims Procedures Manual

Review of the Tort Claims Division written procedures for handling claims revealed the procedures do not provide specific detail regarding documentation and/or investigation of claims. Although the division has a generalized overview of claims procedures and a written description regarding the administrative processing of a new claim, none of the procedures specify what a claimant must submit, how a claim is to be investigated by division staff, or what decisions should be documented and included in the claim file.

Based upon our review of claim files, interviews with agency personnel, and the nature of decision-making required by division staff, there should be specific policies and procedures for the processing of claims by division staff. As a result of not having detailed procedures, we found substantial variation and inconsistency in the method and documentation of claims resolution. Specifically, policies/procedures should provide instruction on the necessary file documentation, the minimum amount of documentation necessary from the claimant to make a claim determination, and documentation of the investigative and decision-making process used to settle or deny a claim. As a supplement to the procedure manual, the division should obtain or develop formalized staff training in the investigation and settlement of claims. This would help ensure consistency in the investigation and documentation of claim processing procedures performed by division staff.

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Claims Administration and Legal Operations

Timeliness of Claim Processing

Section 2-9-301, MCA, states the Department of Administration must grant or deny a claim within 120 days after the claim is presented to the department. Additionally, the statute states the failure of the department to make final disposition of a claim within 120 days after it is presented, must be considered a final denial of the claim. (The 120-day time period is for division processing of a claim and excludes any potential legal action which may occur after claim denial.) During our review, we found many of the claims submitted to the division were not resolved within the 120-day time period. For example, 46 percent (37/80) of the denied claims in our sample were denied after the 120-day time limit, and 35 percent (31/88) of the paid claims were paid after the 120-day time limit.

The Tort Claims Division is not fully complying with the existing statute regarding timeliness of claims processing. As a result, there are sometimes significant delays in the determination of claims. Of our sample of 168 paid and denied claim files, approximately 8 percent took more than a year from the date the division was formally notified until the claim was settled. The delays decrease the responsiveness of the division regarding legitimate claims and increase the potential for loss of accurate, detailed information to aid in claim investigation. Additionally, the delays potentially increase the amount of money the division may have to pay for claims which are based on time-restrictive repair or replacement estimates, such as are common with auto repairs.

Review of claim files indicate one of the reasons for noncompliance with the 120-day time frame is lack of responsiveness by state agencies regarding submittal of reports regarding their claims. Currently, the Tort Claims Division opens a claim file when a formal letter is received from a claimant. No further action is taken on the claim if a vehicle accident report or incident report is needed from an agency for further investigation. However, we found instances where agencies did not submit the necessary documentation for up to a year after they were requested to do so. Another reason for noncompliance is

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likely due to the large turnover in division staff responsible for evaluating claims and making claim determinations. In addition, the division does not have any written guidelines in their policies on how to meet the 120-day time frame. Lastly, there may be delays in the processing of claims because of the lack of trained staff. Interviews with division personnel indicated they have not received any formal training in claim investigation or evaluation.

We believe the statutory 120-day time limit on the determination of claims provides the division with adequate time to investigate and settle claims. This requirement and guidelines for compliance with the time limit should be added to the division's policies and procedures on claims processing. While the issues of timely agency submittal of reports, staff turnover, and lack of formal training have adversely affected the division's ability to comply with this law, compliance should be a division priority.

Claim Notification Procedures

Based on our evaluation of claim files and claim processing procedures, as well as agency visits, we developed several concerns regarding state agency notification to the Tort Claims Division when agency claims occur. The Montana Operations Manual (MOMs) only gives general information regarding agency claim reporting responsibilities. The manual also does not provide adequate direction regarding submittal of claim information. Additionally, the MOMs do not specify what procedures claimant agencies should initiate in the event of a significant property loss.

Our audit findings suggest state agencies do not consistently submit accident and/or incident reports to the Tort Claims Division on a timely basis. A substantial number of claims submitted by agencies were submitted more than six months after the loss occurred. Currently, the MOMs do not specify how soon after a loss the Tort Claims Division should be formally notified. We believe specific time frames should be established for state agencies for the submittal of claims as well

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as for submittal of documentation of any claims filed against them. Additionally, the Tort Claims Division could consider such alternatives as denying agency claims which exceed the established time frames in order to encourage timely submittal of claim information.

During visits to various state agencies, it came to our attention agency personnel were not always aware of the procedures they should initiate in the event of a significant property loss. Additionally, we noted the MOMs do not provide specific steps the agencies should take regarding such a loss. For example, after a recent fire at the Montana College of Mineral Science and Technology, the Assistant Administrator surveyed the damage. While there, he provided guidance and advice to the college officials regarding mitigating circumstances, documentation, and a cautionary note to not move evidence/materials which might affect the outcome of the insurance evaluation. Additionally, the college officials asked questions about how to pay for both short-term and permanent damage repair. While the Assistant Administrator was able to supply answers to their questions, it became apparent from our observations the division needs a more formalized approach to major loss claims than what is outlined in the MOMs.

We believe the Tort Claims Division should develop and distribute to all state agencies via the MOMs, specific procedures to follow regarding the processing of all types of claims. These procedures should include requirements on timely notification of the division, procedures for assuring the avoidance of additional damages, procedures for documenting damages and inventory loss, and general procedures to be used for damage control as well as permanent repair. Additionally, we believe a Tort Claims representative should continue to investigate major loss claims for two reasons: in order to assure the agency of the responsiveness of the Tort Claims Division; and because any property loss up to \$150,000 will be paid from the self-insurance fund. This would provide the division with additional assurance the agencies follow procedural requirements as well as aiding division officials in evaluating an agency's claim.

Summary

Potentially, lack of consistency and standardization regarding internal administrative matters makes it more difficult to train new personnel or get work products which consistently match the expectations of policy makers. Additionally, it makes it difficult to evaluate personnel because there is no formalized criteria or standards to judge against. The reasons for having formal policies and procedures become even more important when an organization such as the Tort Claims Division has nearly 100 percent turnover in staff. We believe the division should develop a comprehensive policy/procedures manual which details internal administrative requirements which all staff should adhere to regardless of their responsibilities. Additionally, there should be policies and procedures to guide staff regarding their specific job responsibilities relative to legal operations and claims processing. Division officials have agreed a policy/procedure manual is a good idea for both insurance and legal operations and have stated it will be pursued as time permits.

Recommendation #13

We recommend the Tort Claims Division establish and communicate comprehensive policies and procedures for all division operations

Chapter VII

Conclusion

Need for More Active Management of Insurance Operations

The performance audit of the Tort Claims Division noted concerns in a number of operational areas. We recommended changes in several areas including:

- The compilation of insurance data to assure adequate insurance coverage and methodologies for billing state agencies for insurance premiums.
- The need for more active risk management by the division.
- The establishment of policies and procedures over the division's claims administration and legal operations.

Overall, our audit findings suggest a need for more active management of division's operations. Many of the concerns we identified were present prior to the employment of current division staff, and division officials are aware of many of these issues. However, as a consequence of a nearly complete turnover in division personnel, division officials (up to this point) have only been able to manage in a reactive manner to many of the noted issues, as opposed to taking a pro-active stance. As a result, the division does not have any formal goals and objectives and only minimal formal policies and procedures to guide division operations.

We believe the Department of Administration's plan to change the division's organizational structure may help the Tort Claims Division. We believe the department should use this organizational change to establish a more long term goal-oriented management stance. The division/department needs to establish a formal plan to actively manage legal and insurance operations. Implementation of this plan will require identification of division priorities and subsequent staffing patterns to address those priorities. At present, the division does not have an accountant, an appraiser, an insurance/claims adjuster, or a full-time risk manager. Nearly all our audit findings show a need for the division to spend more time in areas where, if the above positions were filled and/or more actively pursued by existing staff,

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Conclusion

it could have a positive effect on division operations. Division management should review the current allocation of staff resources in relation to needed operational improvements to determine where additional staff time is necessary.

Need for Additional Communication with Agencies

The Tort Claims Division is a service-oriented organization whose primary functions entail providing services (insurance and legal) to the various state agencies. Based on our audit findings, the division should work more closely with all state agencies. Specifically, the division should help agencies:

- Understand the types and limits of insurance coverage administered by the division.
- Obtain and continually review specialty policies required by the agencies.
- Implement proper procedures for submittal and validation of insurance claims.
- Understand the need for comprehensive "source" data relative to agency assets.
- Understand how insurance premiums are set and billed to the agencies.
- Develop proper procedures for follow-up on inspection reports and other loss prevention work.

We believe if the division establishes a management plan which includes implementation of operational and staffing priorities and increased communication with state agencies, the state will have a more comprehensive insurance program.

Recommendation #14

We recommend the Tort Claims Division:

- A. Develop a comprehensive management plan.**
- B. Identify division priorities and staffing requirements.**
- C. Work more closely with state agencies.**

DEPARTMENT OF ADMINISTRATION

DIRECTOR'S OFFICE



STAN STEPHENS, GOVERNOR

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HELENA, MONTANA 59620

November 27, 1990

NOV 27 1990

Jim Pellegrini, Deputy Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, Montana 59620

Subject: Tort Claims Division Performance Audit

Dear Mr. Pellegrini:

In response to your letter dated November 20, 1990, we have
adjoined our response to your performance audit.

Please let me know if you require any further information.

Respectfully,

Dave Ashley
Dave Ashley
Acting Director

Enclosures

c: Brett Dahl
Scott Seacat

Recommendation #1

We recommend the Tort Claims Division:

- A. Establish specific requirements for agency submittal of information on insurable items.

Response: We concur that agencies need to have specific requirements and guidelines to submit information on insurable items. With our existing staff size we simply must rely on state agencies for certain data on insurable items to provide the insurance protection they need. We have completed some specific guidelines for agencies to follow in supplying such information. Our newly completed vehicle management memo is an example of this effort. We will continue to write and issue guidelines for agencies to follow when submitting data to our office. Our objective is to have a division procedures manual completed by December 1991. Agencies will be informed of procedures; particularly when data is to be submitted to this office.

- B. Initiate procedures to compile and confirm source data submitted by the state agencies.

Response: We will review data source information on a sample test basis as our resources permit. We will incorporate in our procedures manual how agencies are to supply the data and how we will review the data for acceptability. We anticipate completion of this manual by December 1991.

Recommendation #2

We recommend the Tort Claims Division develop and implement procedures to assure all agencies are billed for their portion of commercial insurance premiums.

Response: We concur with the recommendation to develop and implement procedures to assure all agencies are billed in a timely manner for their portion of commercial insurance premiums. Such procedures will be incorporated in our division procedures manual to be completed by December 1991.

Recommendation #3

We recommend the Tort Claims Division evaluate and establish formal support and documentation for self-insurance premium development.

Response: We concur. We plan to review all of our self-insurance coverages and provide support documentation as to how premiums are developed and allocated. This will be a

significant project which may depend on availability of division and outside expertise. Our projected completion date is March of 1992, which will coincide with development of the FY94-95 budget.

Recommendation #4

We recommend the Tort Claims Division ensure premium billing is done in a timely manner.

Response: We concur. The Tort Claims Division had FY91 billings completed prior to August 17, 1990 with the exception of the vehicle billing. The vehicle billing was somewhat delayed because of the development of the management memo but will be completed by December 30, 1990. As we maintain our present staffing we plan to have all billing for FY92 completed by September 1, 1991. We will incorporate our procedures for billing and receiving revenues into our division manual to be completed by December 1991.

Recommendation #5

We recommend the Tort Claims Division develop and implement a formal risk management process.

Response: We concur. We will evaluate the necessity for the development of administrative rules. A program will be established to disseminate and provide information to the state agencies and a risk management committee appointed consisting of members of each agency by December 1991. A status report can be provided to the audit committee in July, 1991.

Recommendation #6

We recommend the Tort Claims Division establish a formal insurance policy review process to evaluate the cost/benefits of the various policies.

Response: We concur and will develop a methodology for reviewing insurance policies to coincide with our bidding process. We will have a mechanism in place for insurance contract analysis by December 1991.

Recommendation #7

We recommend the Tort Claims Division:

- A. Communicate the statutory requirement for centralized insurance administration to all agencies.

Response: We concur. Some agencies, apparently, either do not understand the statutory requirements for a centralized insurance program or are not complying with these provisions.

The form of communication to the agencies will be established in a formalized, written state insurance program by December 1991.

- B. Develop and distribute more detailed information to state agencies on acquisition of insurance.

Response: We concur. To date, a number of management memos have been distributed to the agencies. A more comprehensive program which will bring all these pieces together will be prepared and then presented to the agencies as part of our ongoing efforts to enhance inter-agency communications in the areas of insurance and risk management by December 1991.

Recommendation #8

We recommend the Tort Claims Division increase its evaluation and management of the Self-Insurance Reserve Fund by:

- A. Developing more comprehensive loss statistics.

Response: We partially concur. We have already developed a comprehensive data base. Development of a loss reserving mechanism for estimating potential reserve balance deficiencies is beyond the expertise of our staff and requires in many cases actuarial training.

- B. Establishing a plan for sustaining the Self-Insurance Reserve Fund on an actuarially sound basis.

Response: We concur. Timely collection of premium billings, the development of justifiable rates to include administrative costs and a strategy to manage the self-insurance fund reserve will be developed by December 1991.

Recommendation #9

We recommend the Tort Claims Division:

- A. More clearly document the reasons used to pay or deny tort claims.
- B. More fully document decisions regarding settlement amounts.

Response: We concur. Files presently include all documentary information upon which settlement decisions are made, but not all files contain explanations of the reasoning behind the ultimate decisions. The tort claims division is implementing a procedure to document settlement decisions, provided such a procedure will not disadvantage the state in future settlement negotiations, should the Montana Supreme Court rule that such documentation cannot be made confidential.

Recommendation #10

We recommend the Tort Claims Division establish documentation detailing the reasons for attorney selections.

Response: We concur. The tort claims division continually revises its attorney selection procedures to insure competent and cost-effective representation. The division is implementing a procedure to document the selection process which should be fully implemented by July 1991.

Recommendation #11

We recommend the Tort Claims Division:

- A. Separate the attorney selection and attorney payment approval functions.
- B. Improve contract administration related to contract attorneys.

Response: We concur. With the separation of the administrator and chief defense counsel functions the division has separated the attorney selection and attorney payment approval functions.

Recommendation #12

We recommend the Tort Claims Division compile and maintain data on staff attorney workload.

Response: We partially concur. The division has compiled this information during four of the last five years, but has lacked sufficient clerical staff to properly maintain or utilize this documentation. The division will once again evaluate the need for a new tracking system.

Recommendation #13

We recommend the Tort Claims Division establish and communicate comprehensive policies and procedures for all division operations.

Response: We concur. The Tort Claims Division will develop a comprehensive internal policy and procedures manual for all division operations. These policies will be communicated to state agencies by December 1991.

Recommendation #14

We recommend the Tort Claims Division:

- A. Develop a comprehensive management plan.

Response: We concur. We have just reorganized the division and are in the process of designing our management plan as

well as our operations and procedures manual. Both are to be completed by December 1991.

- B. Identify division priorities and staffing requirements.

Response: We concur. The division priorities will be incorporated in our management plan. The staffing requirements have been evaluated and proposed in the executive budget process. An overall staffing analysis will be included in the management plan.

- C. Work more closely with state agencies.

Response: We concur that our division's work requires close interaction with state agencies. In our development of management memos and operational procedures we will involve state agencies through a risk management committee.

